Due service of the within Brief is hereby acknowledged this.....day of September, A. D. 1938.

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Attorneys for Petitioners.

INDEX.

CASES CITED.

AUTHORITIES AND TEXT BOOKS CITED.

Supreme Court of the United States

October Term, 1938

No. 21.

WM. H. NEBLETT, et al.,

Petitioners,

vs.

SAMUEL L. CARPENTER, Jr., et al.,

Respondents.

BRIEF OF RESPONDENT DOUGLAS E. C. MOORE

STATEMENT OF CASE.

This respondent, Douglas E. C. Moore, with others, intervened in the proceedings in the lower court in California at their inception (R. p. 233). Respondent was a stockholder of the old company and a member of its board at the time the intervening petition, to which this respondent was a party, was filed (R. p. 233). The intervening petition referred to directly raised the issue of due process of law and impairment of contract rights under the Constitution of the United States (R. p. 242).

The brief is limited to a discussion of points "G" and "J", so designated in the petition for writ of certiorari.

ARGUMENT.

"The power to reorganize cannot be implied from the right of the Commissioner as Conservator to enter into rehabilitation agreements" (Point G, petitioner brief).

The California statute, under which the reorganization here was effected, does not in terms purport to be a reorganization statute.

The first paragraph of the opinion of the Supreme Court of California indicates that the proceedings were taken

> "pursuant to the provisions of Section 1043 of the Insurance Code",

a copy of which will be found at page 64 of the petition for writ of certiorari.

The Supreme Court of California, in its opinion, said:

> "The proceedings here under review were taken under Sections 1010 to 1061 of the Insurance Code adopted in 1935" (See page 1532 of Record).

There is nothing in any of these sections of the Code, or the Code as a whole, which deals with reorganization in the sense of either "deferred liquidation" or in the sense of modifying the contract rights of creditors.

Although the Court correctly stated, that the

> "Several of the provisions contained therein in reference to the rehabilitation of insolvent insurance companies were new sections in this state, having been copied substantially from similar provisions in the New York Insurance Law."

the sections of the New York Insurance law, upon the basis of which reorganizations in the true sense were permitted and held valid, are wholly missing from the California Code.

The case of People v. Van Shaick (National Surety Company case), 268 N. Y. Supp. 88, deals with the subject of the New York reorganization statute as applied to insurance companies. In that case the court said (page 98) that the commission acted under chapter 40 of the

Laws of 1933, and that that statute was a moratorium statute which authorized the commissioner to:

> "make, rescind, alter and amend rules and regulations imposing any condition upon the conduct of the business of any insurer which may be necessary or desirable to maintain sound methods of insurance and to safeguard the interest of policyholders, beneficiaries and the public generally during such period (of emergency). Such rules may be inconsistent with existing law, and in such case it may supersede it."

To the same effect see Title & Mortgage Guaranty Company case, 264 N. Y. 69.

As a reorganization statute, the California Act would have been invalid unless it was based upon and asserted to be based upon emergency conditions.

See Home Building & Loan Assn. v. Blaisdell, et ux., 290 U. S. 398, 54 S. Ct. 231, where the court said, at page 240:

> "This principal precludes a construction which would permit the state to adopt as its policy the repudiation of debts or the destruction of contracts or the denial of means to enforce them. But it does not follow that conditions may not arise in which a temporary restraint of enforcement may be consistent with the spirit and purpose of the constitutional provision and thus be found to be within the range of the reserved power of the state to protect the vital interests of the community."

At page 242 the court said:

> "An emergency existed in Minnesota which furnished a proper occasion for the exercise of the reserved power * * *. The declarations of the existence of this emergency by the Legislature and by the Supreme Court of Minnesota cannot be regarded as a subterfuge or as lacking in adequate basis. The finding of the Legislature and state court has support in the facts of which we take judicial notice * * *. In view of the nature of the contracts in question * * * the relief afforded and justified by the

> emergency, in order not to contravene the constitutional provision, could only be of a character appropriate to that emergency, and could be granted only upon reasonable conditions."

In the instant case no emergency was declared by the Legislature to exist, nor was it asserted or found by the Court.

Even if California had a moratorium statute, and even if it had been passed under a declared and recognized emergency, the action here taken would not have been valid because there is nothing in the record to show that the action was appropriate to an emergency, nor that the plan approved was a fair and reasonable exercise of emergency powers.

The plan does not purport to be a temporary suspension of remedies or rights. It fixes them permanently. There is nothing in the plan or in the decision which justifies the discrimination between different classes of creditors, excepting only the bare assertion that the premiums paid by one class of policyholders was inadequate for the protection they were promised.

The statute does not purport to authorize or provide for a plan of deferred liquidation, such as was involved in Doty v. Love, 295 U. S. 64, 55 S. Ct. 558.

A comparison of the California statute with the Mississippi statute involved in the case of Doty v. Love demonstrates this to be true.

Nor can the plan adopted be said to come within the minimum requirements of deferred liquidation approved in the case of Doty v. Love.

In that case the statute expressly provided:

> "This Act shall not be construed to give the Superintendent of Banks the right to diminish the assets of a closed bank to the prejudice of the depositors and creditors thereof."

Not only is there no such provision in the California statute, but the approved plan of reorganization does diminish the assets of the old company to the prejudice of its creditors.

In the instant case, all or substantially all of the assets were turned over to the new company for the purpose of paying and protecting the rights of all creditors except those holding non-can. policies, and permitting them to come under the reorganization without diminution of rights. Non-can. creditors were neither protected nor permitted to come in without substantial reduction in their rights.

The plan is set forth in the approved Rehabilitation and Reinsurance Agreement, found at Record page 1396, which includes a provision for the establishment in the new company of a participating life insurance department. Certain assets of the company from among its general assets, subject to certain limitations, are declared to be "held absolutely for the security of and benefit of the policyholders of the participating department as though it belonged to a mutual company carrying on no other business" (f. 4223, R. p. 1408).

Point J.—"The contracts of the petitioner and all other policyholders have been impaired in violation of Article 1, Section 10 of the Federal Constitution."

Our discussion of this point is limited to the rights of holders of non-can. policies.

There is no finding that the non-can. policyholders who dissent from the plan of reorganization, will receive payment in full for the damages they have suffered, nor that they will receive as large a percentage of their claims as

they would have received upon liquidation, nor that they will receive the same without unreasonable delay.

See National Surety Co. v. Corlell, 289 U. S. 426, 53 S. Ct. 678.

The appeal to the California Supreme Court rested in part upon the claim that the judgment roll discloses "that it was not preceded by findings of fact and conclusions of law". (Quotation from opinion of California court, at page 1529 of Record.) The fact that there were no findings is manifest from the record. The court's answer was twofold: (1) "The properly authenticated record does not disclose that findings were not waived" (R. p. 1529). The court refused to accept an affidavit by Neblett to the effect that findings were demanded and refused (R. p. 1530). The court's second answer was that "the proceeding here involved is a special proceeding in which findings are not required" (R. p. 1530). In this connection the court said:

> "The Commissioner was not prosecuting an action 'for the enforcement or protection of a right', or for the 'redress or prevention of a wrong', or for the 'punishment of a public offense' * * *. The proceeding is not one in which another party is prosecuting another party at all. It is simply a proceeding in which the state is invoking its power over a corporate entity permitted by the state to engage in a business vitally affected with the public interest upon condition of continuing compliance with the requirements provided by the state. It is not a controversy between private parties but a proceeding by the state in the interest of the public" (R. p. 1531).

The section of the statute under which the reorganization was said to be impliedly authorized was enacted in 1935, long after most of the non-can. policies went into

effect. To construe that statute retroactively so as to affect the contract rights of the non-can. policyholders then in existence violates the contract clause of the Constitution.

Northern P. R. Co. v. Minnesota, 208 U. S. 583, 28 S. Ct. 341.

American Jurisprudence, Vol. 12, Sections 389, 390.

The insurance code of California under which these proceedings were had, contemplates an equality of distribution, in case of insolvency, to all unsecured creditors. Section 1033, California Insurance Code—Codes of California, 1937, Deering.

Section 1034 of the same Code contemplates the recovery by the commissioner of preferences.

The care which is required in nonadversary proceedings to obtain the approval of the Supreme Court in reorganization matters is indicated in the case of National Surety Co. v. Coriell, above referred to. Many of the conditions there set forth on the basis of which that case was reversed are patently present here. In that case the court said (681):

> "The nonassenting creditors were entitled to have the plan and their objections considered in an orderly way, and to a decree based on adequate data."

There is nothing in the record to show that this was done here.

> "There was no evidence on which the court could have found even that a majority of the unsecured creditors favored the plan."

The same is true here.

> "There was no valuation of the assets by a disinterested appraiser."

There is no showing that that was done here.

"The failure to require relevant data before deciding whether the plan should be approved was not cured by the declaration of the Circuit Court of Appeals that the dissenting creditors were entitled to an aliquot share of what, a year later, might be estimated the property would have brought at a public sale."

Even that much is not proposed here. On the contrary, the preference in favor of certain creditors is made final.

"The proceeding was not an adversary one" (p. 682).

The same is true here.

"The jurisdiction rested wholly upon the consent of the defendant corporation."

The same is true here.

Although both the Supreme Court and the trial Court in California found that the plan was fair and equitable, there is nothing whatsoever in either decision to show that sufficient facts were developed in this proceeding, said to be "not a controversy between private parties" so that this Court can, as it will insist upon doing, determine that no constitutional rights have been violated. This it must do unless it were to rest upon mere conclusions without any showing of facts.

The entire matter of binding dissenters under state reorganization laws is in the process of formation, and to permit rights of dissenters to be ignored or concealed under presumptions and mere rules of practice, and not on the basis of substantive evidence, would be the last straw in breaking down constitutional safeguards. See discussion in note in Harvard Law Review, volume 48, commencing at page 1414.

No State legislature has any reserve power to legalize a plan of reorganization of an insurance company, except it be done pursuant to so-called emergency legislation. See Gilfillan v. Union Canal Co., 109 U. S. 401, 404, 3 S. Ct. 304; Canada Southern Ry. Co. v. Gebhard, 109 U. S. 527, 3 S. Ct. 363.

In the Gebhard case they were dealing with a reorganization pursuant to Canadian law, valid in Canada, and the issue was as to its extraterritorial effect in this country. The Gebhard case laid down the doctrine, recently affirmed by this court (Modern Woodmen of America v. Mixer, No. 308, 267 U. S. 544, 45 S. Ct. 389, 69 L. Ed. 783),

> "that the legal relations of the members of a corporation to the corporation and to each other must be regulated and controlled by the law of the jurisdiction in which the corporation is organized, and it extended the doctrine so as to make it applicable to mortgage security holders having a common interest in the corporate property."

The Gebhard case is distinguishable from the Pacific Mutual case in the following respects: in the Gebhard case the rights of the bondholders were limited by the express provision of the bond and the mortgage, by the peculiar nature and character of the security, and by the laws of Canada under which the bonds were issued. See Gates v. Boston & N. Y. Air-Line R. Co., 5 Atl. 695, which discusses these distinctions. There was nothing to deny, and in fact to the contrary it appeared, that in the Gebhard case the corporation was paying its debts to the extent of its financial ability. It was not made to appear in the Pacific Mutual case that the corporation was providing for its non-can. policyholders to the extent of its financial ability. In this connection, see

Coriell v. Morris White, Inc., 54 F. (2d) 255, where the court said:

> "A scheme for the reorganization of a corporation which does not provide for the payment of its debts to the extent of its financial ability, impairs the obligation of the contract by which credit was extended to it."

For this court's own interpretation and restriction upon the construction of the Gebhard case, see Second Russian Ins. Co. v. Miller, 45 S. Ct. 593, 268 U. S. 552.

The rule in the Gebhard case has never been applied to a situation such as is here involved, and its application was limited by the peculiar facts in that case, among which may be cited the following statements from the opinion. The court said at page 368 of the opinion in 3 Supreme Court Reporter:

> "In the absence of statutory authority, or some provision in the instrument which establishes the trust, nothing can be done by a majority, however large, which will bind a minority without their consent."

The court then proceeds to point out that in the Gebhard case there was legislative power:

> "for binding the minority in a reasonable way by the will of the majority."

The court then proceeds to point out that in the Gebhard case there was involved a corporation which was created for a public purpose; that it had its corporate home in Canada, subject to the exclusive legislative authority of the Dominion parliament. When the bondholders bought their bonds they were, in legal effect, informed that they were entering into contract relations, not only with a foreign corporation, but with the holders of other bonds of the same series, who were relying

equally with themselves for their ultimate security on a mortgage of property devoted to a public use, situated entirely within the territory of a foreign government.

The court said further:

> "It follows, therefore, that anything done at the legal home of the corporation, under the authority of such laws, which discharges it from liability there, discharges it everywhere. * * * It is not in conflict with the constitution of the United States, which, although prohibiting states from passing laws impairing the obligation of contracts, allows congress 'to establish * * * uniform laws on the subject of bankruptcy throughout the United State'." (pp. 370, 371).

Since the non-can. policies were issued in this case the law in this country has been developed so as to justify what would otherwise amount to an impairment of contract rights, when an emergency exists, and is declared by competent authority. That is the only exception to the rule which protected these policyholders against impairment of their contract rights.

That rule, as above pointed out, does not apply to this case. The doctrine of the Gebhard case is limited in its application and does not extend to the facts in this case.

Respectfully submitted,

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